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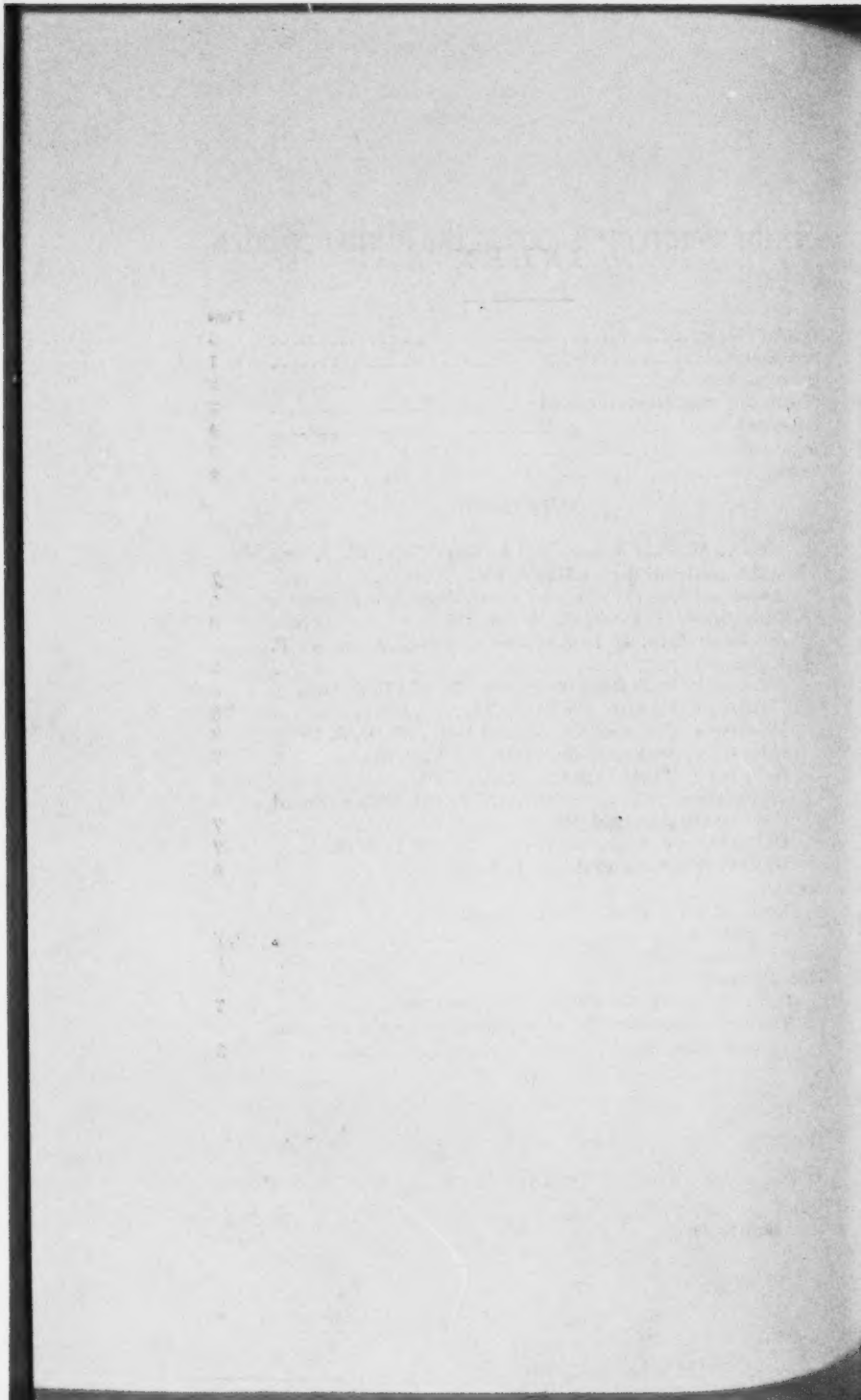

In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 456

AIR REDUCTION COMPANY, INCORPORATED,
PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the United States Board of Tax Appeals is unreported. (R. 18.) The opinion of the Circuit Court of Appeals (R. 36) is reported in 130 F. (2d) 145.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered August 1, 1942. (R. 44.) The petition for a writ of certiorari was filed October 14, 1942. Jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended.

QUESTIONS PRESENTED

1. Whether a corporation is taxable upon the profit realized in 1935 (a) through the exchange of its own repurchased treasury stock for the stock of another corporation, and (b) through the sale of similarly repurchased treasury stock to its employees. This question in turn depends upon the applicability of Treasury regulations under the Revenue Act of 1934, which differed from the regulations under the earlier revenue acts.

2. Whether the acquisition by a corporation, in exchange for its own stock, of a portion of the voting stock of another corporation constitutes a "reorganization" within the meaning of Section 112 (g) of the Revenue Act of 1934, if other portions of the voting stock had previously been purchased by the acquiring corporation for cash.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried

on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * * * *

(b) *Exchanges solely in kind.*—

* * * * *

(3) *Stock for stock on reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

* * * * *

(g) *Definition of reorganization.*—As used in this section and section 113—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, * * *

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 22 (a)–16. *Acquisition or disposition by a corporation of its own capital stock.*—Whether the acquisition or disposi-

tion by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Act.

STATEMENT

The following material facts are contained in the findings of the Board of Tax Appeals:

1. The petitioner is a New York corporation engaged principally in the manufacture and sale of

oxygen and other derivations of air, acetylene, and carbide. (R. 16.)

During 1935 the petitioner exchanged 5,258 shares of its treasury stock, which it had previously reacquired at a cost of $182,536.73, for 22,347 shares of the stock of Pure Carbonic Company of America, the fair market value of the latter being $888,602. (R. 16.) This exchange of stock was made between petitioner and U. S. Industrial Alcohol Company. (R. 17.) During 1935 Pure Carbonic Company was operated as a subsidiary of petitioner. (R. 17.) Previous to the exchange in question petitioner had purchased 14,771 shares of Carbonic Company for cash. (R. 17.) This purchase plus the stock already owned by petitioner and the subsequent exchange here in question gave petitioner ownership of the entire outstanding stock of Pure Carbonic Company. (R. 17.)

2. Also during the year 1935, petitioner sold to various officers of its company 3,200 shares of its treasury stock for $184,480 which it had previously reacquired for $120,973.81. (R. 17.) This stock was sold pursuant to options granted the officers some two years before. (R. 17.)

In computing its net taxable income, the petitioner did not include the difference between the cost of the 5,258 shares of its own stock, which it

held as treasury stock, and the value of the 22,347 shares of Pure Carbonic stock received in exchange therefor. (R. 16–17.) Petitioner did include as taxable income the difference between the cost of its 3,200 shares and the amount received therefor upon the sale to officers of the company but later sought a refund of the tax so paid on the ground that the inclusion of this item was erroneous. (R. 17.)

The Board of Tax Appeals held that the petitioner realized no taxable gain in either of its transactions and that it had overpaid its tax for the year involved. (R. 20.) The Circuit Court of Appeals reversed and remanded on both questions.

ARGUMENT

1. This case arises under the Revenue Act of 1934; and the regulations promulgated under that Act (Regulations 86, Article 22 (a)–16, *supra,* pp. 2–4) have always provided that a corporation which realizes a profit from dealing in shares of its own stock is subject to tax with respect thereto. Although it is true that the regulations under the earlier acts did not so provide, there is not here presented any such question of retroactive application of amended regulations as was involved in *Helvering* v. *R. J. Reynolds Tobacco Co.,* 306 U. S. 110. The propriety of a prospective amendment of Treasury regulations has been firmly established. *Helvering* v. *Wilshire Oil Co.,* 308

U. S. 90; *Helvering* v. *Reynolds*, 313 U. S. 428; *American Chicle Co.* v. *United States*, No. 913, 1941 Term; cf. *White* v. *Winchester Club*, 315 U. S. 32, 39–40. And the lower courts have uniformerly upheld the applicability of the regulations here involved to transactions consummated after the enactment of the 1934 Act. *Trinity Corp* v. *Commissioner*, 127 F. (2d) 604 (C. C. A. 5), certiorari denied October 12, 1942, No. 220, 1942 Term; *Allen* v. *National Manufacture & Stores Corp.*, 125 F. (2d) 239 (C. C. A. 5), certiorari denied May 4, 1942, No. 1091, 1941 Term; *Investment Corp. of Philadelphia* v. *United States*, 43 F. Supp. 64 (E. D. Pa.). Moreover, the court below correctly ruled, following the regulations, that the profit realized through the transactions in its own shares was taxable; the corporation was here dealing "in its own shares as it might in the shares of another corporation." That the regulations were intended to apply in such circumstances was explicitly recognized in G. C. M. 16,651, XV–2 Cum. Bull 130.[1]

[1] Both the petition and brief of *amici curiae* undertake to argue generally that the profit here involved cannot be taxed as "income". However, it has been frequently recognized that Section 22 (a) defining gross income is co-extensive with constitutional power (*Helvering* v. *Stockholms &c. Bank*, 293 U. S. 84, 89; *United States* v. *Safety Car Heating Co.*, 297 U. S. 88, 93), and the charge that such profit cannot be taxed as income is therefore wholly without substance. In essence, this case raises only the question whether the regulations are valid.

2. Although no plan of reorganization is even remotely involved, petitioner also contends that the exchange of its voting stock for the voting stock of its subsidiary constituted a "reorganization" within Section 112 (g) of the Revenue Act of 1934, and that therefore the profit realized was relieved of tax under Section 112 (b) (3). *Commissioner* v. *Dana,* 103 F. (2d) 359 (C. C. A. 3), is cited in support of this proposition and in conflict with the decision below. The *Dana* case, which is questionable even as an interpretation of the Act there involved, dealt with a "reorganization" as defined by Section 112 (i) of the Revenue Act of 1928. The instant transaction, however, is governed by the 1934 Act which provides that a reorganization occurs if in the exchange the petitioner gives *solely* its voting stock. The difference which the addition of the word "solely" in the later Act creates in the operation of the two Acts was treated in *Helvering* v. *Southwest Consolidated Corp.,* 315 U. S. 194, which turned on precisely that point. That decision not only renders the *Dana* case no longer applicable but controls this case.

Petitioner attempts to avoid the ruling of the *Southwest Consolidated* case by asserting that it acquired enough stock in the subsidiary through the exchange of securities alone to constitute the transaction a reorganization, without any neces-

sity for considering the stock it purchased for cash. But this argument misses the point. The requirement that the petitioner acquire the stock of the subsidiary *solely* in exchange for its own stock applies to all acquisitions of the subsidiary's securities, not just to acquisitions of 80 percent of them, as the language of the statute makes clear.[2] The statute imposes two separate conditions, first, that the corporation must acquire at least 80 percent of the voting securities, and second, that the exchange be solely for its own stock. There is no basis in the statute for circumventing the second condition, merely because 80 percent of the securities had been acquired for stock.

Moreover, the 22,347 shares of Pure Carbonic Company which petitioner acquired in exchange for its own stock constituted far less than 80 per cent of the Carbonic Company's stock. It was only by uniting this exchange with other exchanges in prior years that the requisite percentage was attained; and the record does not disclose that the various exchanges were part of a single plan of reorganization. Accordingly, neither the transac-

[2] The statute provides that the term "reorganization" means "the acquisition by one corporation in exchange solely for all or a part of its voting stock: of *at least* 80 per centum of the voting stock and *at least* 80 per centum of the total number of shares of all other classes of stock of another corporation." [Italics supplied.]

tion here in question (involving less than 80 per cent of the Carbonic Company's stock), nor all the exchanges taken together, fall within Section 112 (g).

CONCLUSION

The decision of the circuit court of appeals is correct, and there is no conflict. We respectfully submit that the petition for certiorari should be denied.

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